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RHEBAAA/DEPT OF ENERGY
RHEHNSC/NSC WASHDC
RUMIAAAA/HQ USSOUTHCOM MIAMI FL
RUCPDOG/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY

C O N F I D E N T I A L CARACAS 000769

SIPDIS

ENERGY FOR CDAY AND ALOCKWOOD
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR MMALLOY
NSC FOR JSHRIER
COMMERCE FOR 4431/MAC/WH/MCAMERON

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TAGS: [ECON](#) [EINV](#) [ETRD](#) [VE](#)
SUBJECT: VENEZUELA'S ECONOMIC GROWTH SLOWS IN FIRST QUARTER

REF: A. 2007 CARACAS 2040

- [1](#)B. CARACAS 566
- [1](#)C. CARACAS 376
- [1](#)D. CARACAS 68
- [1](#)E. CARACAS 313
- [1](#)F. CARACAS 609

Classified By: Acting Economic Counselor Shawn E. Flatt for Reasons 1.4
(b) and (d).

[1](#)1. (C) Summary: Central Bank figures for the first quarter of 2008 show that Venezuela's economy is continuing to grow, but at a slower rate. First quarter growth was 4.8 percent in 2008, a marked decrease from the 8.8 percent registered in the first quarter of 2007. While the Central Bank lauded the economy's 18th consecutive quarter of growth, independent analysts attributed the slowdown directly to more restrictive BRV monetary policies. We believe the slowdown is an indication of the ultimate unsustainability of the BRV's economic model, although increasing oil prices will allow the BRV to give the economy a further boost in the short term. End summary.

Slowing Down

[1](#)2. (U) First quarter results indicate that Venezuela's economy continues to grow, but that the growth rate is slowing. According to Central Bank (BCV) figures published on May 27, GDP grew 4.8 percent in real terms (base year 1997) during the first quarter of 2008 relative to the same period in 2007. This rate represents a marked deceleration from the 8.8 percent growth registered in the first quarter of 2007 relative to the same period in 2006. Planning Minister Haiman El Troudi argued that "seasonality" explained the deceleration and that the economy would pick up in coming quarters and surpass the BRV's goal of 6 percent for the year (ref A). (Note: El Troudi's explanation of seasonality is unconvincing. In 2007, first quarter growth was actually slightly higher than annual growth, comparing both periods to the corresponding periods in 2006. End note.)

It Depends How You Spin It

¶3. (U) The BCV described Venezuela's economic performance as "favorable and sustained," noting that the economy had registered its 18th consecutive quarter of growth. The BCV specifically noted the 3.3 percent growth in the petroleum sector, attributing it to improved crude production in the former strategic associations and operating service agreements. (Note: Although 3.3 percent is less than the overall growth rate, it is at least positive; the petroleum sector contracted in real terms in 2007. End note.) Fueled by increasing oil prices, the current account surplus increased by 200 percent in the first quarter of 2008, even as imports jumped 20 percent.

¶4. (U) Yet independent analysts were quick to point out red flags in the BCV's numbers. As in the past several years, growth was strongest in the non-tradable sectors, especially communications (17.6 percent growth), and weaker in sectors such as manufacturing (1.4 percent) where Venezuelan producers are subject to international competition. In sharp contrast to the past several years, construction turned in a weak performance (2.6 percent growth) and gross fixed capital formation and financial services actually contracted in real terms (by 1.8 and 6.4 percent, respectively; for a discussion of the banking sector, see ref B). Foreign direct investment in Venezuela was negative, and the overall capital and financial account showed a deficit that was larger in absolute terms than the current account surplus. In other words, reserves declined by over USD 3 billion, largely a result of BRV-mandated transfers from the BCV to the National Development Fund.

Comment: An Indication of Things to Come

¶5. (C) Most economic analysts attributed the slowdown to the impact of BRV actions, particularly a set of more restrictive monetary policies to contain the parallel rate and inflation (ref C). While these policies, which the BRV began to experiment with in 2007, are contributing factors, we believe the slowdown in growth is part of a more general and predictable trend. As argued more fully in ref D, Venezuela's strong post-2003 economic growth is largely a result of a consumption boom sparked by massive government spending made possible by increasing oil prices. In the absence of significant investment in productive capacity, this model is bound to end in high inflation (which already exists) and low or negative growth. The inflation results from increased demand and circulating money (liquidity) without a corresponding increase in local production. The expectation of low or negative growth follows from the fact that at some point, assuming oil prices do not increase indefinitely, the government will no longer be able to increase the spending that fuels the growth. Given the current continued increase in oil prices, the BRV can temporarily delay a further decline in the growth rate by increasing its spending again, and indeed most analysts expect it to do just that in the run-up to state and local elections later this year. So while overall 2008 growth may well be more than 4.8 percent, we expect it to be significantly lower than the 8.4 percent registered in 2007.

Impact on the Population

¶6. (SBU) It is perfectly plausible that an economy simultaneously has strong real economic growth and high inflation, a situation Venezuela appears to be in for the moment. In this case, assuming that the growth and inflation were evenly distributed, the population at large should see an increase in real purchasing power regardless of price increases. This statement holds because the amount of production and the relative price of goods determines the purchasing power of a given producer, not the overall price level. For example, if one person doubles his bread production and another doubles her butter production, each can eat twice as much bread and butter even if the prices of

bread and butter both quadruple, as long as the relative prices stay the same (i.e., as long as if by selling the same amount of bread one can buy the same amount of butter). In an economy whose terms of trade are improving, overall domestic purchasing power receives a further boost because the relative price changes allow the country to purchase more imports with a given quantity of exports.

17. (SBU) What is curious about Venezuela's economy currently is that real economic growth is apparently strong and terms of trade are clearly improving yet, according to several market survey firms, many Venezuelans are finding that their real purchasing power is starting to decline with ever-rising prices (ref E). There are several potential explanations for this phenomenon. First, there may be measurement problems. As mentioned above, the BCV measures real economic growth using 1997 as a base year - i.e., using constant 1997 prices.

For statistical reasons that relate to changes in relative prices and consumption patterns, the longer the interval between the base year and the current year the more upwardly biased the real growth measurement becomes. A BCV statistician estimated to Econoff that if the base year were 2007, the figure for real economic growth in 2008 would likely be half of what it will be using 1997 as a base year. According to the statistician, the BCV is in the process of updating the base year to 2007, but this change will not take place until 2009 at the earliest.

18. (C) A second explanation is that the benefits of real economic growth and the costs of inflation are not equally distributed, and therefore a proportion of people are losing real purchasing power even as the overall economy is growing.

Many Venezuelans, including poor Venezuelans, are increasingly finding themselves in this situation. BCV figures, which break out inflation by income quartile, indicate that poorer Venezuelans face inflation several percentage points higher than wealthier Venezuelans, as one would expect given the rapid increase in food prices and higher percentage of food items in the consumption basket of the poor. Furthermore, the mechanisms the BRV has used to transfer money to poorer Venezuelans are becoming less effective (ref E). While the recent increase of 30 percent in the minimum wage and in most public sector salaries (ref F) will temporarily give many poorer Venezuelans a boost in purchasing power, their medium-term prospects are not good.

FRENCH